

Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-07 FRB-01

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FM AMEMBASSY COPENHAGEN

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AMEMBASSY DUBLIN

AMEMBASSY THE HAGUE

AMEMBASSY LONDON

AMEMBASSY LUXEMBOURG

AMEMBASSY PARIS

AMEMBASSY ROME

UNCLAS COPENHAGEN 3340

EO 11652: N/A

TAGS: EFIN, DA

SUBJECT: DISCOUNT INCREASE TO COUNTER PRESSURES ON KRONER

REF: COPENHAGEN 2592

SUMMARY: THE DANISH OFFICIAL DISCOUNT RATE WAS INCREASED
OCTOBER 5 TO A RECORD LEVEL OF 11 PERCENT, UP 2.5 PERCENT.
THE INCREASE WAS OFFICIALLY MOTIVATED BY THE NEED TO REDUCE
PRESSURES ON THE DANISH KRONE AND ON FOREIGN EXCHANGE
RESERVES. IT WAS SIMULTANEOUSLY ANNOUNCED THAT RESERVES
DURING SEPTEMBER DWINDLED BY \$300 MILLION TO THE LOWEST
LEVEL SINCE 1971. THE DISCOUNT INCREASE HAD NO
IMMEDIATE EFFECTS UPON THE COPENHAGEN FOREIGN EXCHANGE
MARKET TODAY BUT THE ALREADY DEPRESSED BOND MARKET YIELDED
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FURTHER DESPITE ACTIVE OPEN MARKET SUPPORT BY THE

NATIONAL BANK. END SUMMARY

1. THE DANISH NATIONAL BANK (CENTRAL BANK) TODAY (OCTOBER 5) INCREASED THE OFFICIAL DISCOUNT RATE FROM 8.5 PERCENT TO A RECORD LEVEL OF 11 PERCENT. THE NATIONAL BANK'S LOWEST LENDING RATE (TO COMMERCIAL BANKS) WAS INCREASED FROM 9 TO 11.5 PERCENT AND THE ORDINARY LENDING RATE (THE SO-CALLED SECOND TRANCHE RATE) WAS INCREASED FROM 9.5 TO 14 PERCENT.

2. THE NATIONAL BANK COMMENTS THAT THE DISCOUNT RATE INCREASE MUST BE VIEWED IN THE LIGHT OF THE SPECULATIVE PRESSURES IN INTERNATIONAL EXCHANGE MARKETS PRECEDING THE GERMAN ELECTIONS WHICH HAVE PRESSED THE DANISH KRONE TOWARD THE BOTTOM OF THE SNAKE. THE NATIONAL BANK CONCEDES, HOWEVER, THAT PART OF THE PRESSURE AGAINST THE KRONE IS DUE TO THE CONTINUING LARGE DEFICIT IN THE CURRENT ACCOUNT OF THE BALANCE OF PAYMENTS. WHILE THIS DEFICIT HAS BEEN LARGELY COVERED BY PUBLIC SECTOR CAPITAL IMPORTS, THERE HAS AT THE SAME TIME BEEN A TENDENCY IN THE PRIVATE SECTOR TO EXPEDITE PAYMENT OF FOREIGN DEBTS. THIS HAS LED TO A NET LOSS OF RESERVES. THE NATIONAL BANK ADDS THAT INTEREST DEVELOPMENTS IN THE DOMESTIC SHORT TERM MARKET HAVE ALSO PROMPTED AN ADJUSTMENT OF NATIONAL BANK RATES.

3. THE HIGHEST DISCOUNT RATE PREVIOUSLY REGISTERED WAS 10 PERCENT BETWEEN JANUARY 1974 AND JANUARY 1975. THE DISCOUNT RATE WAS LOWERED TO 9 PERCENT IN JANUARY, 8 PERCENT IN APRIL, AND TO 7.5 PERCENT IN AUGUST OF 1975. IT WAS RAISED TO 8.5 PERCENT IN MARCH, 1976.

4. SIMULTANEOUSLY WITH THE ANNOUNCEMENT OF THE NEW DISCOUNT INCREASE CAME THE REPORT OF AN ALMOST \$300 MILLION LOSS OF RESERVES DURING THE MONTH OF SEPTEMBER, DESPITE CONTINUED GOVERNMENT BORROWING ABROAD. THIS REDUCED FOREIGN EXCHANGE RESERVES TO ABOUT \$700 MILLION, INCLUDING LIMITED GOLD STOCKS, SDR'S AND IMF RESERVES. THIS IS THE LOWEST MONTH-END FIGURE SINCE 1971.

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5. FOLLOWING THE OIL CRISIS, DENMARK, AS MOST OTHER WESTERN COUNTRIES, EXPERIENCED A DETERIORATING BALANCE OF PAYMENTS THROUGH THE FIRST HALF OF 1974. THE CURRENT DEFICIT THAT YEAR REACHED ABOUT \$900 MILLION. HOWEVER, IMPROVEMENT DURING THE SECOND HALF OF 1974 LASTED THROUGH THE FIRST THREE QUARTERS OF 1975 WHEN THE CURRENT BALANCE OF PAYMENT ACCOUNT APPROACHED EQUILIBRIUM. THE TEMPORARY VAT REDUCTION IN THE LAST QUARTER OF 1975 HAD

THE UNFORTUNATE EFFECT OF BOOSTING IMPORTS RATHER THAN DOMESTIC PRODUCTION AND ANOTHER BOP DEFICIT OCCURRED. THE 1975 DEFICIT TOTALLED \$535 MILLION.

6. DESPITE RECENT INDICATIONS OF AN IMPROVING EXPORT PERFORMANCE, THE DANISH FOREIGN TRADE ACCOUNT REMAINS VERY NEGATIVE IN 1976 AND THE CURRENT BALANCE OF PAYMENTS DEFICIT THIS YEAR IS LIKELY TO REACH ABOUT \$1,700 MILLION. THUS FAR THIS YEAR, THE DANISH GOVERNMENT AND OTHER PUBLIC AUTHORITIES HAVE BORROWED ABOUT \$1,200 MILLION ABROAD AND ARE STILL ACTIVELY IN THE MARKET IN ORDER TO COVER THE REMAINING DEFICIT. THE PRIVATE SECTOR'S FOREIGN CAPITAL ACCOUNT WILL PROBABLY REMAIN CLOSE TO NEUTRAL.

7. THE NATIONAL BANK'S RESERVE MANAGEMENT IS FURTHER COMPLICATED BY THE EXISTING PRESSURE ON THE FORWARD MARKET WHICH HAS LED TO THE ACCUMULATION OF LITERALLY ALL DANISH RESERVES IN THE COMMERCIAL BANKING SYSTEM. IN BOTH AUGUST AND SEPTEMBER, THE NATIONAL BANK WAS FORCED TO DRAW ON SHORT TERM CREDITS IN DENMARK, REPORTEDLY TO THE TUNE OF \$170 MILLION EACH MONTH. THE GERMAN ELECTION RESULT AND CHANCELLOR SCHMIDT'S RENEWED ASSURANCES OF SNAKE PRESERVATION HAVE NOT YET RESULTED IN ANY RELAXATION OF THE FORWARD MARKET.

8. THE DANISH DISCOUNT INCREASE DID NOT MATERIALLY AFFECT THE COPENHAGEN FOREIGN EXCHANGE MARKET TODAY WHERE ONLY MINOR ADJUSTMENT WERE REGISTERED.

9. THE DOMESTIC BOND MARKET OVER THE PAST MONTHS HAS REGISTERED SHARP INCREASES IN THE RATES OF MORTGAGE INTEREST TO LEVEL BETWEEN 16 AND 17 PERCENT.
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THE MARKET AGAIN REACTED NEGATIVELY OCTOBER 5 AND ONLY ACTIVE OPEN MARKET SUPPORT BY THE NATIONAL BANK CURTAILED ANOTHER INCREASE. INDICATIONS ARE THAT THE MARKET MAY REACH THE RECORD LEVEL OF INTEREST OF 18 PERCENT REGISTERED IN 1974. IF MAINTAINED, THIS WILL HAVE DETRIMENTAL EFFECTS FOR INVESTMENT, ESPECIALLY IN THE CONSTRUCTION SECTOR, AND HENCE FOR EMPLOYMENT.
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